

Purpose and strategy

Our strategy is founded on broadening and deepening our customer relationships. Improving our customer service is a key part of this. Transforming our costs gives us the oxygen to invest in our networks and in the products and services our customers want. This is explained in the following pages.

The section starts with an introduction from our Chief Executive.



Our purpose

Our purpose is to use the power of communications to make a better world.



Our goal

Our goal is to deliver sustainable profitable revenue growth. This will support cash flow growth over the long term, which we will use to reward our shareholders and other stakeholders.



Our culture

We want to build and sustain a culture that helps us respond quickly and effectively to changes in our markets.

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This Strategic Report was approved by the Board on 4 May 2016.

By order of the Board

Dan Fitz
Group General Counsel
& Company Secretary
4 May 2016



Chief Executive's introduction

2015/16 has been a landmark year for us.

Our lives and work are now built around connectivity – and our expectations are constantly rising. Our customers' demand for data is increasing exponentially, and we want to be able to access files, stream entertainment or use applications wherever we are, on any device, seamlessly.

I'm proud that it's BT's networks, products and services that lead the way in many of these areas. And our strategy of innovation and investment has helped, and will continue to help us lead and shape the digital future in the years to come, and to broaden and deepen relationships with our customers.

This year we've brought EE into the BT family. By bringing together the UK's best mobile network with the best fixed network, it puts us in a great position to meet the growing demand from UK consumers, businesses and the public sector for converged digital services.

The integration of EE is going well and we now see the opportunity to deliver more synergies than we originally expected, and at a lower cost. The acquisition has also allowed us to refresh our organisational structure, with a sharper focus on serving customers both in the UK and internationally.

We've also passed a number of landmarks on our fibre investment. Over 25 million premises can now get superfast broadband – around 85% of the country – and we're on track to help take coverage to 95% and beyond. We continue to lead other major European nations on almost all measures of speed and connectivity.

This year has also seen us develop a range of exciting new products, services and content.

We've grown our TV business by around one-third this year alone. It's benefited from the halo effect created by BT Sport, as well as from other investments we've made in this area such as the exclusive launch of AMC.

I'm very pleased with how customers have responded to our UEFA Champions League and UEFA Europa League content, with BT Sport audiences up 45% this year. And we broadcast the UK's first ever live matches in Ultra HD.

With our business customers, we're seeing great demand in the UK and around the world for our products and services, in particular our IP and cloud-based services, and our cyber-security products.

We've also made progress on service this year. Openreach hit all 60 of the minimum service levels set by Ofcom, and BT Consumer complaints are now 50% lower where our agents are multi-skilled. We've also launched

a number of tools that give customers greater control over their orders, bills and services. Our new 'My BT' app for example, has been downloaded more than 435,000 times so far, as customers increasingly want to use digital channels for service. 'View my Engineer' also allows customers to track engineer appointments.

Despite these improvements, I know we're not where we want to be. As connectivity becomes ever more critical to how we live and work, our customers have rising expectations of the service we provide, and quality of service is becoming more important than price alone. That's why Openreach is tackling missed appointments, why BT Consumer will be upgrading service levels to next day repair and why we've hired 900 engineers. We've also recruited more than 900 extra contact centre staff which will enable us to return EE and BT Consumer contact centre work to the UK.

Our continued investments in our people, network and products will also enable us to improve the experience delivered by our contact centres, remove failure and change the way we interact with customers.

Today we help millions of people connect to friends and family and have a wealth of information and entertainment at their fingertips. We help companies work smarter and compete around the world, and we enable essential public services to be delivered.

Our aim to become a fully converged service provider will allow us to create and deliver a whole new generation of products and services. It will provide a foundation for all areas of our business, deliver for our customers and generate huge opportunities in the years ahead.

Our commitment to using the power of communications to make a better world, and to making sure we're always broadening and deepening our customer relationships, means we're confident that BT will remain right at the heart of what's to come – delivering significant value for our customers and employees, for our shareholders, and for society.

A handwritten signature in black ink that reads "Gavin Patterson". The signature is written in a cursive, flowing style.

Gavin Patterson
Chief Executive
4 May 2016

Our purpose

Our purpose is to use the power of communications to make a better world.

We're here to meet the needs of our customers, delivering the experience, products and services that matter to them. Millions of individuals connect through us to their friends and family, and have huge amounts of information and entertainment at their fingertips. The smallest companies, right through to multinational corporations, use our services every day to conduct their business. Many public services rely on our technologies. And in the UK, most of the telecoms industry operates across our networks – we help more than 500 other communications providers to serve their customers.

Our success as a business depends on delivering value to all our customers. We try to think ahead, anticipate what they want and develop products, services and an overall experience that meet their needs, whether as individuals or as businesses.

Our services are vital to our customers and their communities. We look for ways of using and developing those services to deliver economic growth and wider societal benefits. To bring our purpose to life, we've set a number of challenging long-term ambitions that make a positive impact on the societies, communities and environment we operate in (page 45).

By creating value for our customers and society, we grow our business and reward our shareholders for investing in us.

Our goal

Our goal is to deliver sustainable profitable revenue growth.

In previous years, we relied on cost transformation to offset declining revenues, so that we could grow our cash flows and the value of our business. This year, we grew our revenue, driven by the investments we've been making.

In the years ahead, we expect profitable revenue growth, combined with continued transformation of our costs, to provide a platform for long-term and sustainable cash flow growth.

We'll reinvest some of the cash we generate back into the business, to help us to grow over the long term. A virtuous circle. And we'll also use it to pay dividends to our shareholders and reward other stakeholders.

Our strategy

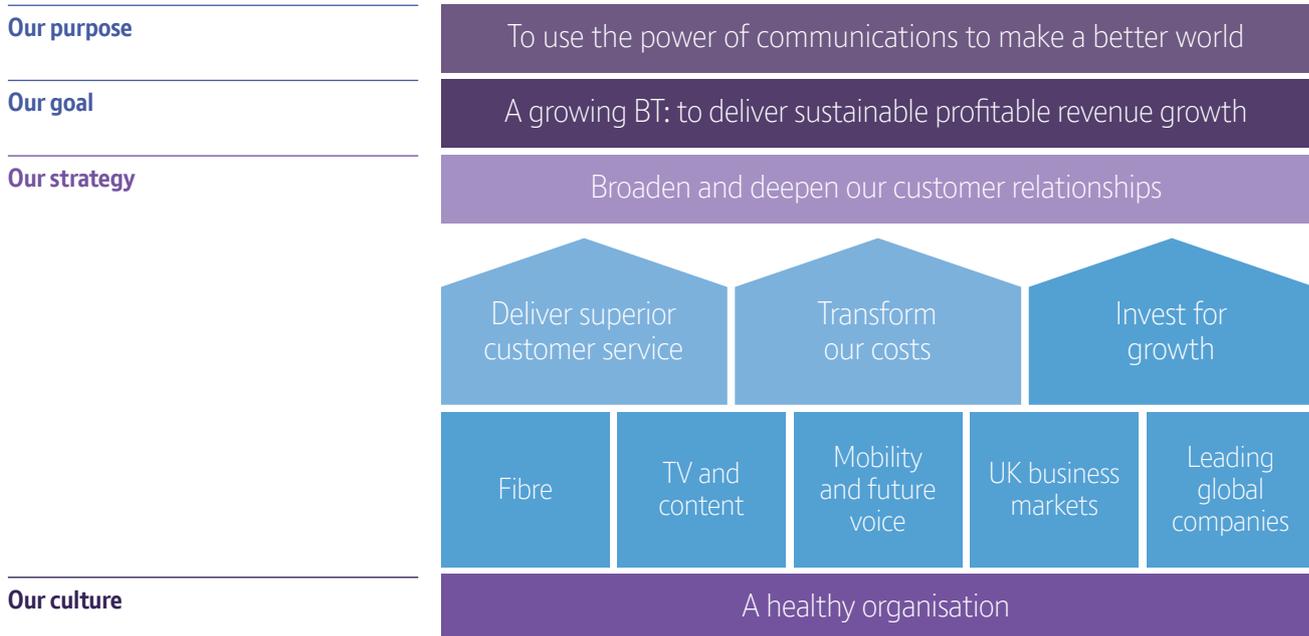
Our strategy is founded on broadening and deepening our customer relationships.

To deliver sustainable profitable revenue growth, we need stronger relationships with our customers. That means making sure we stay relevant to them as markets, lifestyles and technologies change.

The three pillars of our strategy help us do that: delivering superior customer service; transforming our costs; and investing for growth. The better our customer service, the more we'll sell and the less time and money we'll spend putting things right. And the better we manage our costs, the better value for money we can offer our customers and the more we can invest in giving customers what they need – today and tomorrow. These are the principles that drive our business model (page 28).

The diagram below shows our strategy in the year and how it supports our goal and purpose. It sits at the centre of our business model.

For 2016/17 our strategy is evolving. The three pillars remain broadly the same but with a wider focus on the overall customer experience rather than just on customer service. And with the acquisition of EE our investment areas are evolving to focus on having the best integrated network in the UK and being a fully converged service provider.



Deliver superior customer service

Every day we touch the lives of millions, providing services that help people get the most out of their working and personal lives. Our customers' experience is affected by the quality, reliability and value of our products and services. And by how responsive we are when we need to provide new services or sort out problems. Their expectations continue to rise as our networks play an increasingly important role in their lives and businesses.

Getting the customer experience right, and improving the quality of our customer relationships, is at the heart of our strategy for growth. And also supports our drive for cost transformation.

Customer experience is one of the measures we use to set our executives' annual bonus. It is made up of the Right First Time (RFT) metric and a customer perception measure (see page 130). RFT is our key internal measure of customer service. It tracks how often we keep the promises we make to our customers.

How we did in the year

Our performance in the first quarter of the year was good. But in the second, third and fourth quarters, our service was impacted by electrical storms and system and network outages, as well as 11 separate winter storms over a five-month period. The storms resulted in record levels of flooding and while we received much praise for our response, they had a significant impact on our service. We recovered well in the fourth quarter and ended the year with a positive upturn in our service measures. But we missed our RFT target for the year as a whole. Performance was down 3.0% against a 4.7% increase in the prior year.

We need to redouble our efforts into next year as we know that we need to do much better. We're investing in jobs and we're multiskilling our people to give us better flexibility and capacity.

In last year's Annual Report we outlined a number of specific areas that we would focus on this year. We've made good progress against each of these, although we recognise that we need to do more.

Acting on insight

We've redesigned the way we launch new products to more clearly reflect customer feedback and insight.

BT Mobile was our first product launch in which customer experience was a specific design criteria from the outset. Our net promoter score is highest among consumers taking BT Mobile.

We're rolling out this approach to other products under development.

Keeping our customers connected

We've invested more to help make our services more resilient. Our investment in proactive network maintenance is up by 22%, improving the fault profile of our network.

Creating great tools and systems

Our new 'My BT' app won a Digital Experience Award, and has been downloaded more than 435,000 times. 51% of users check the app monthly and 21% use it weekly. We're updating it every quarter. Recent developments include letting customers pay their bills, monitor their broadband usage, find out about network issues, and view their orders and any faults.

In BT Wholesale we've invested significantly in our online capabilities including: improved search engines and navigation; personalised online order and fault management; and better online chat support.

Working better across our organisation

We've invested in broadening our contact centre agents' skills and tools, letting them take greater ownership of customer issues and increasing the number of issues addressed in a single call.

Where we've introduced this, in relation to the provision of new connections, complaints are 50% lower and customer satisfaction is up more than 17%. We're extending this model across all our contact centres.

Supporting our people

We're bringing our call centres back to the UK, with 60% of BT Consumer customer calls being answered within the UK by the end of the year. And we're planning to extend that to 90% by the end of March 2017.

To do this we've hired more than 900 people in the UK and plan to hire a further 1,000 over the course of the year ahead.

EE is creating 600 new roles to support its plans to handle all customer service calls in the UK and Ireland by the end of 2016.

Key priorities

Looking ahead, we're focused on:

- investing further in our network, making it more resilient;
- reducing the number of appointments missed by our engineers;
- hiring more people into our contact centres;
- investing more in our contact centre advisers, giving them the skills and tools to solve more customer issues; and
- improving our online tools to make it easier for customers to serve themselves.

Transform our costs

Our approach to cost transformation

We run large and complex cost transformation programmes, led by a team of consultants. These consultants are BT people. They know our business better than anyone.

Our approach is based on a methodology honed over a decade. It's underpinned by forensic data analysis, strong governance and the support of senior management.

Our largest cost transformation activities are driven 'top-down'. They might be end-to-end programmes spanning multiple lines of business or complex changes contained within a single line of business. Continuous Improvement (CI) provides a complementary 'bottom-up' approach. CI makes small but important changes to how we do things every day. It has the added benefit of improving employee engagement.

Training is a key part of our approach. We have an in-house Cost Transformation Faculty, part of the BT Academy (page 32). The faculty is responsible for the continued development of our 'change professionals'. This year we trained and coached more than 900 people. BT is the only UK organisation licensed by the British Quality Foundation to certify qualifications to the most advanced levels in Lean^a, Six Sigma^b and Change & Project Management methodologies on such a scale.

How we did in the year

This year, our underlying operating costs excluding transit were up 2% mainly reflecting higher leaver costs and our investment in BT Sport Europe. These offset our cost transformation activities. Over the last seven years we've reduced our operating costs and capital expenditure by over £5bn.

Programmes this year included:

- reviewing and improving our end-to-end process for planning engineer visits. By creating centres of excellence where planners are based together, streamlining processes and improving systems, we're reducing the cost of failure, eliminating inefficiencies and improving service;
- developing a new operating model to govern how we serve the UK business market. By consolidating our sales and marketing teams, we'll reduce administrative effort and duplication, and focus our people on what really matters – selling to customers;
- consolidating our IT functions to improve data security, system stability and to gain economies of scale. We've also made sure that our people have access to the right training programmes, career opportunities and are sharing best practice;
- rationalising, standardising and automating our internal reporting function. We've also created a data analytics capability to improve decision-making and provide support on larger transformation programmes;
- improving the efficiency and productivity of our off-shore shared service centres. In particular, we're reducing the administrative resource required to operate these centres; and
- reviewing and redesigning our overseas operations with the aim of ensuring that back-office functions are done from centres of excellence located in low-cost countries. We've also continued to apply best practice from our UK operations.

Key priorities

Looking ahead, we're focused on:

- realising substantial cost synergies from the integration of BT and EE (page 98);
- streamlining our Ethernet delivery and broadband repair processes with the aim of improving customer experience and reducing cost;
- reducing our network costs in the UK and overseas, which account for a large proportion of our overall costs; and
- rationalising and standardising our products, networks, applications and platforms, to remove complexity and reduce cost.

We're confident that there are plenty of opportunities to reduce costs further. We see well over £1bn of gross opportunity over the next two years, much of which can be reinvested for growth. We continue to benchmark our cost of doing business against other large telecoms companies. While we've continued to improve our performance, we still see opportunity to do even better. Increasingly we look beyond the world of telecoms to other industries to identify more opportunities.

You can read about cost transformation within our lines of business from page 57. And the group's operating costs are described on page 98.

^a Lean is a methodology for achieving small, incremental changes in processes in order to eliminate waste and improve efficiency and quality.

^b Six Sigma is a data-driven methodology for eliminating defects in processes.

Invest for growth

We're investing in five strategic areas. These are the things we believe will deliver sustainable profitable revenue growth – which will deliver value for our shareholders.

Fibre

We've long been at the forefront of fibre innovation and investment and we aim to keep it that way.

Our superfast fibre broadband network now reaches around 85% of the UK. With other networks, this takes availability to 90%. We plan to extend coverage even further, so that fibre availability goes beyond the UK Government's current 95% target by the end of 2017.

We plan to start rolling out ultrafast broadband based on G.fast technology next year. Our new service is capable of delivering speeds of 300-500Mbps. We're trialing the technology in a number of locations, including Huntingdon in Cambridgeshire and Gosforth in Tyne and Wear. With the right regulatory environment, the service will reach 10m homes and smaller businesses by the end of 2020 (with an ambition to get this to 12m), and the majority of premises within a decade.

Our ultrafast ambitions also include rolling out significantly more fibre-to-the-premises (FTTP). We intend to build FTTP infrastructure in new housing developments in the UK. We're also conducting trials to explore if FTTP can be installed faster and more efficiently in business parks and high streets. These trials – and feedback from industry – could lead to a new FTTP product being developed for SMEs with speeds of up to 1Gbps and strong service guarantees.

TV and content

We've continued to improve our TV proposition:

New sports channel – We launched BT Sport Europe, which is now the home of UEFA Champions League and UEFA Europa League football. We'll show 350 matches each season for three years.

New services – We introduced a number of innovative services, including BT Sport Ultra HD – the first Ultra HD sports service in Europe. We launched BT Sport's Connected Red Button service, which allows BT TV viewers to switch between matches and use a new 'Goal Alert' function to keep track of the action across a range of games.

Richer content – We continued to add popular content and TV channels. We secured the exclusive rights to show the next Ashes cricket series. And we extended our rights to the FA Cup by another three years to 2021.

Read more about these developments in the BT Consumer section on page 73.

Mobility and future voice

We completed the acquisition of EE. We're now the UK's leading communications provider, bringing together the UK's best 4G network with the UK's largest fibre network.

We want to transform the shape of communications by creating more innovative, converged products and services. We'll address different parts of the consumer mobile market by using both the EE brand and the BT Mobile brand.

We're making progress towards our goal that by 2025 all our voice customers will be served using an IP voice solution, having migrated off our traditional telephony platform.

UK business markets

We've continued to improve our product portfolio. We're now better placed to meet the needs of our customers as they increasingly adopt IP and cloud-based services.

We're reorganising our structure to take better advantage of the opportunities to grow our share of the UK business market. And to strengthen and deepen our relationships with UK customers. On 1 April 2016, we created a new line of business, 'Business and Public Sector'. It will serve businesses – large and small – as well as the public sector in the UK and the Republic of Ireland.

Leading global companies

We're investing in our products, network and expertise to increase our share of spending by our large multinational customers (page 59). A particular area of focus is the 'cloud'. We're investing in new services that allow large organisations around the world to connect easily and securely to the applications and the data they need. We want to empower companies so they can integrate and orchestrate IT resources, irrespective of where they are hosted.

New services launched this year included:

- an extension of BT Cloud Connect to provide connectivity to HP Enterprise Helion Managed Cloud Services;
- a cloud-based Distributed Denial of Service (DDoS) mitigation service; and
- BT Assure Cyber Defence, an advanced security platform.

Our culture

We want to build and sustain a culture that helps us respond quickly and effectively to changes in our markets. This is vital to the delivery of our strategy. We continue to make organisational changes with the aim of improving our culture and our ability to perform well. These changes centre on:

- unifying the organisation around a common set of values;
- putting the customer first in everything we do;
- developing a leadership style which helps to drive change and gives people the confidence to take responsibility; and
- making BT an exciting place to work and a company our people are proud to work for.